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Anglo-Canadian Telephone Company

715 VICTORIA SQUARE, MONTREAL, QUEBEC H2Y 2H7

ANNUAL REPORT 1979

ANGLO-CANADIAN TELEPHONE COMPANY (Incorporated under the Quebec Companies Act)

Directors

THEODORE F. BROPHY
ROGER CHARBONNEAU
JOHN H. E. COLBY
JOHN J. DOUGLAS
WILLIAM H. HARRISON
WILFRED R. JOYCE
JOEL P. MELLIS
WILLIAM C. ROWLAND

Officers

WILLIAM H. HARRISON
President

WILFRED R. JOYCE
Vice-President, Secretary and Treasurer

JOEL P. MELLIS
Assistant Secretary

LYLE E. ORSTAD
Assistant Treasurer

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CUMULATIVE PREFERRED STOCK
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Toronto, Winnipeg, Vancouver, Saint John, Halifax and Calgary

COMMON STOCK
The Company

Si vous préférez recevoir ce rapport en français, veuillez vous adresser au secrétaire,
La Compagnie de Téléphone Anglo-Canadienne, 715 Square Victoria, Montréal, Québec H2Y 2H7

To the Shareholders:

March 17, 1980

Our Canadian operations showed significant improvement in 1979. Consolidated telephone operating revenues increased to $784.8 million or 22.2% over 1978, reflecting increased long distance calling volumes, additional telephones in service and an annual rate increase of $11 million by one of our subsidiaries. In addition, revenues included $18.3 million which were part of $25.3 million previously deferred by another subsidiary in compliance with the Anti-Inflation Act Guidelines ("Guidelines"). The balance of $7 million was refunded to subscribers.

Consolidated net income of $31.1 million for 1979 was 28.7% higher than last year, reflecting the increased revenues, income from manufacturing operations due to a recent acquisition by one of our subsidiaries, and increased dividends from our Dominican Republic subsidiary. These earnings improvements were partially offset by increased costs resulting from the implementation of certain accounting refinements ordered by the Canadian Radio-television and Telecommunication Commission ("CRTC"), together with an increase in depreciation rates on switching equipment.

Expansion and improvement of facilities to accommodate the growth and service upgrading requirements of our Canadian telephone operating subsidiaries required capital expenditures of more than $299 million during 1979, an increase of 13.1% over the year 1978. Capital expenditures during 1980 are estimated at $345 million.

The number of telephones serviced by our Canadian subsidiaries increased during 1979 by 5.9% to a total of 2,051,985.

British Columbia Telephone Company

British Columbia Telephone Company, 45.94% owned by Anglo, and 9.28% owned by one of Anglo's affiliated companies, reported 1,786,648 telephones in service at the end of 1979, a gain of 6.1% for the year. Gross expenditures for telephone plant during 1979 were $285 million, an increase of 19.7% over the strike disrupted prior year, bringing total investment in plant to $2.3 billion at year-end. Excluding adjustments related to the Guidelines in both years, telephone operating revenues in 1979 rose to $657 million or an increase of 14% over 1978, reflecting a 15% increase in long distance calling volumes and a record increase in the number of telephones in service. Net earnings for the year amounted to $51.8 million or $1.92 per ordinary share compared with $33.8 million or $1.55 per share in 1978, reflecting the effect of the increased revenues, including those previously deferred, offset in part by increased operating expenses resulting from increases in depreciation rates and the accounting refinements imposed by the CRTC.

On September 29, 1979, the Company acquired two telecommunications equipment manufacturing companies, GTE Automatic Electric (Canada) Ltd., and its subsidiary, GTE Lenkurt Electric (Canada) Ltd., from GTE International Incorporated, an affiliate of Anglo, in exchange for 2,757,876 ordinary shares valued at $47.4 million. Subsequently, these companies merged to form a new subsidiary, AEL Microtel Limited. Net earnings included in the results reported above for three months from these operations amounted to $1.9 million.

Québec-Téléphone

Québec-Téléphone, 53.79% owned by Anglo, had 265,337 telephones in service at year-end, an increase of 4.5% during the year. Gross expenditures for new plant and equipment in 1979 amounted to

$36 million and the Company plans to spend approximately $268 million over the next five years to continue its expansion and modernization program. Operating revenues increased 20.4% to $101.3 million for the year, reflecting a 7.4% increase in long distance calling, the increase in telephones in service and a rate increase of $11 million effective April 1, 1979. Net income available for ordinary shares increased proportionately by 20.3% to $9 million. Earnings per share amounted to $2.72 per share compared with $2.49 per share for 1978.

Dominican Republic Subsidiary

Compania Dominicana de Telefonos C. por A., a wholly-owned subsidiary of Anglo, had 147,636 telephones in service at year-end, a gain of 2.1% over 1978. Gross expenditures on new plant and equipment during 1979 amounted to $9.4 million bringing the total gross plant investment to more than $123 million by year-end. Operating revenues increased by 22% to $51.6 million and net income was $11.3 million, an increase of 13.5% over last year. Dividend remittances are still restricted under governmental regulations, thereby preventing a reasonable return on the equity investment by Anglo in this company. Therefore, income from this subsidiary continues to be reflected in Anglo's consolidated financial statements on a cash basis. In 1979, $1.7 million of dividends were remitted to Anglo as compared to $467,000 in 1978.

The good financial results of our subsidiary companies are evidence of the commitment and dedication by our managements and staff. We will continue our efforts to improve the growth and performance of our companies in the future.

On behalf of the Board of Directors

William J. Harrison

President

Consolidated Balance Sheets

December 31, 1979 and 1978

Assets

	1979	1978
	(Thousands of dollars)	
FIXED ASSETS:		
Telephone plant, at cost	$2,682,324	$2,473,533
Accumulated depreciation	(636,717)	(557,887)
	2,045,607	1,915,646
Cost of investments in subsidiaries in excess of underlying book value as of the dates of acquisition	31,118	32,533
	2,076,725	1,948,179
Manufacturing property, at cost	43,420	—
Accumulated depreciation	(23,338)	—
	20,082	—
INVESTMENTS:		
Investment in unconsolidated subsidiary	46,008	46,008
Other	5,847	4,318
	51,855	50,326
CURRENT ASSETS:		
Cash and short-term deposits	7,264	5,543
Receivables (including unbilled revenues)	122,851	90,712
Inventories	50,304	—
Other	6,364	5,681
	186,783	101,936
DEFERRED CHARGES:		
Unamortized cost of issuing long-term debt	2,622	2,961
Unamortized loss on foreign exchange	10,791	12,097
Other	513	727
	13,926	15,785
	$2,349,371	$2,116,226

Signed on behalf of the Board:

JOHN H. E. COLBY, Director WILLIAM H. HARRISON, Director

The accompanying notes form an integral part of these consolidated financial statements.

Shareholders' Equity and Liabilities

	1979	1978
	(Thousands of dollars)	
SHAREHOLDERS' EQUITY:		
Anglo-Canadian Telephone Company:		
Preferred shares (See page 8)	$ 37,500	$ 37,500
Common shares (Note 2)	12,037	12,037
Premium on common shares	34,218	34,218
Reinvested earnings	203,804	174,985
	287,559	258,740
Minority interest in consolidated subsidiaries:		
Preference and preferred shares (See page 8)	285,327	258,249
Common shares and reinvested earnings	268,989	197,461
	554,316	455,710
	841,875	714,450
LONG-TERM DEBT (See page 8)	865,501	918,701
CURRENT LIABILITIES:		
Loans for construction expected to be refinanced	112,486	15,109
Current portion of income debentures	12,000	12,000
Accounts payable and accrued liabilities	74,570	49,541
Due to affiliates	10,978	8,108
Advance billings and customer deposits	19,533	41,994
Dividends	9,410	7,460
Accrued interest	18,500	18,034
Accrued taxes	16,803	16,028
	274,280	168,274
DEFERRED CREDITS	367,715	314,801
COMMITMENTS AND CONTINGENT LIABILITIES (Note 4)		
	$2,349,371	$2,116,226

Consolidated Statements of Income

For the years ended December 31, 1979 and 1978

	1979	1978
	(Thousands of dollars)	
TELECOMMUNICATIONS OPERATIONS		
Operating Revenues:		
Toll service	$434,674	$370,669
Local service	300,786	272,840
Miscellaneous	30,974	23,872
Excess revenues (Note 3)	18,325	(25,325)
	784,759	642,056
Operating expenses (Note 3):		
Operations	388,322	326,457
Depreciation	166,982	131,168
Income taxes	76,557	55,670
	631,861	513,295
Operating earnings	152,898	128,761
Other income	3,962	1,792
Allowance for funds used during construction	5,897	11,481
Income before interest charges	162,757	142,034
Interest charges	86,212	80,792
Income from telecommunications operations	76,545	61,242
MANUFACTURING OPERATIONS		
Sales	47,850	—
Costs and expenses:		
Cost of sales	40,735	—
Selling and administrative expenses	3,997	—
Interest charges	819	—
Income taxes	368	—
	45,919	—
Income from manufacturing operations	1,931	—
Combined income before minority interest	78,476	61,242
Minority interest in net income and preference and preferred dividends of subsidiaries	49,095	37,555
Income from Canadian operations	29,381	23,687
Dividends from unconsolidated subsidiary	1,703	467
Consolidated net income	$ 31,084	$ 24,154

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Statements of Reinvested Earnings

For the years ended December 31, 1979 and 1978

	1979	1978
	(Thousands of dollars)	
BALANCE AT BEGINNING OF YEAR	$174,985	$187,624
ADD —		
Consolidated net income	31,084	24,154
	206,069	211,778
DEDUCT —		
Dividends paid on common shares	—	34,218
Dividends paid on Cumulative Preferred shares		
4½% Cumulative Preferred shares	281	281
$2.90 Cumulative Preferred shares	363	363
$2.65 Cumulative Preferred shares	848	848
$3.15 Cumulative Preferred shares	567	567
Share issue expenses of consolidated subsidiaries	206	516
	2,265	36,793
BALANCE AT END OF YEAR	$203,804	$174,985

Consolidated Statements of Funds Used for Capital Expenditures

For the years ended December 31, 1979 and 1978

	1979	1978
	(Thousands of dollars)	
FUNDS FROM OPERATIONS:		
Consolidated net income	$ 31,084	$ 24,154
Less — Dividends paid on preferred shares	(2,059)	(2,059)
	29,025	22,095
Add (deduct) — Expenses not requiring cash outlay:		
Depreciation	171,804	131,168
Deferred income taxes	48,525	34,178
Allowance for funds used during construction	(5,897)	(11,481)
Other — net	11,158	8,861
	254,615	184,821
FUNDS FROM FINANCING:		
Shares of subsidiaries issued (Note 1)	90,496	57,577
Sale or issuance of long-term debt, net of redemptions and unamortized loss on foreign exchange	(55,154)	131,297
Increase (decrease) in loans for construction	97,377	(121,006)
	132,719	67,868
OTHER SOURCES (USES) OF FUNDS:		
Dividends paid on common shares	—	(34,218)
Decrease (increase) in working capital, excluding construction loans	(76,218)	46,041
Acquisition of subsidiary (less working capital acquired of $33,816) (Note 1)	(13,543)	—
Other — net	1,897	241
	(87,864)	12,064
CAPITAL EXPENDITURES	$299,470	$264,753

The accompanying notes form an integral part of these consolidated financial statements.

ANGLO-CANADIAN TELEPHONE COMPANY and Subsidiaries

Summary of Preferred and Preference Shares and Long-Term Debt

December 31, 1979 and 1978

	Shares	1979	1978
		(Thousands of dollars)	
PREFERRED AND PREFERENCE SHARES:			
Anglo-Canadian Preferred shares, par value $50 per share, cumulative dividend. Authorized 1,000,000 shares redeemable at $53 per share; outstanding 750,000 shares:			
4½% Cumulative Preferred shares	125,000	$ 6,250	$ 6,250
$2.90 Cumulative Preferred shares	125,000	6,250	6,250
$2.65 Cumulative Preferred shares	320,000	16,000	16,000
$3.15 Cumulative Preferred shares	180,000	9,000	9,000
		$ 37,500	$ 37,500
Subsidiaries' Preference and Preferred shares:			
British Columbia Telephone Company			
6% Cumulative Redeemable Preference and Preferred shares ($100 par value)		$ 5,500	$ 5,500
4⅜% to 5¾% Cumulative Redeemable Preferred shares ($100 par value)		48,000	48,000
4.84% to 10.16% Cumulative Redeemable Preferred shares ($25 par value)		200,910	156,700
$2.32 Cumulative Redeemable Convertible Subordinate Preferred shares ($25 par value)		3,892	19,584
Québec-Téléphone			
4¾% to 9¾% Cumulative Redeemable Preferred shares ($20 par value)		26,759	28,156
$1.68 Cumulative Redeemable Convertible Subordinate Preferred shares ($15 par value)		249	289
Premium on Subordinate Preferred shares		17	20
		$285,327	$258,249
LONG-TERM DEBT:			
Anglo-Canadian Telephone Company			
6½% Sinking Fund Debentures, Series A, due 1983		$ 780	$ 1,040
Income Debentures due 1982 at an interest rate of ½ Canadian Prime plus ½%		23,500	35,500
British Columbia Telephone Company and subsidiaries			
First Mortgage Bonds 5% to 11%, due 1981 - 2003		726,357	746,897
First Mortgage Loan 11%, due 1992		—	28,029
Notes payable 6% to 15¾%		3,260	—
Amounts due under capitalized equipment leases		4,125	—
Québec-Téléphone			
First Mortgage Redeemable Sinking Fund Bonds 5½% to 11⅞%, due 1982 - 1996		112,294	112,591
General Mortgage Sinking Fund Bonds 5¾% due 1983		3,725	3,800
Total principal amount		874,041	927,857
Less - Unamortized discount on long-term debt		8,540	9,156
Total long-term debt		$865,501	$918,701

The accompanying notes form an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

For the years ended December 31, 1979 and 1978

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Principles of consolidation

All subsidiaries have been included in the consolidated financial statements except for a wholly-owned subsidiary in the Dominican Republic.

The consolidated subsidiaries and equity ownership at December 31, 1979, were as follows:

	Percent Owned
British Columbia Telephone Company	45.94
Dominion Directory Company Limited	100.00
Québec-Téléphone	53.79
York Investment Co. Ltd.	100.00

GTE International Incorporated, Stamford, Connecticut, an affiliated company, also owned 9.28% of the outstanding common shares of British Columbia Telephone Company of which 4.55% were deposited in a voting trust with the British Columbia Resources Investment Corporation.

During 1977, management reached a decision to place the earnings from Compania Dominicana de Telefonos, C. por A. (''Dominicana'') on a cash basis in the consolidated financial statements of Anglo-Canadian Telephone Company (''Anglo''). This decision was reached because of diminished prospects for local government approval of remittance of adequate dividends on Anglo's equity investment in Dominicana. Accordingly, 1979 and 1978 consolidated results of operations do not include any revenues or earnings from this subsidiary except for $1,703,000 and $467,000 of dividends received during 1979 and 1978, respectively. The investment in Dominicana is being carried at its net book value as of December 31, 1976; earnings will be recorded only as dividends are remitted. This treatment will continue as long as the aforementioned conditions exist.

Management of the Dominican subsidiary has been and is continuing to seek approval for a general rate increase. It is also attempting to obtain approval of increased dividend remittances. Management is of the opinion that the carrying value of the investment in Dominicana as of December 31, 1979, will ultimately be realized in full.

Summary financial information for Dominicana, translated to Canadian dollars, is as follows:

	1979	1978
	(Thousands of dollars)	
Telephone plant, less accumulated depreciation	$ 93,249	$ 94,650
Total assets	129,555	123,240
Long-term debt	47,547	52,077
Net book value	67,642	62,578
Net earnings before unrealized gain or loss on translation from pesos to Canadian dollars	11,254	9,919

The above information has been translated from Dominican pesos (at par with the $U.S.) to Canadian dollars following the method proposed by the Canadian Institute of Chartered Accountants entitled ''Translation of Foreign Currency Transactions and Foreign Currency Financial Statements''.

On September 29, 1979, British Columbia Telephone Company acquired 100% of the outstanding common shares of GTE Automatic Electric (Canada) Ltd. and its subsidiary GTE Lenkurt Electric (Canada) Ltd., through the issuance of 2,757,876 ordinary shares valued at $47,359,000. Subsequently, these subsidiary companies merged to form AEL Microtel Limited (''Microtel'').

Notes to Consolidated Financial Statements

Microtel is engaged in the business of manufacturing a variety of equipment used in telephone switching systems. It is also a manufacturer of transmission equipment, related components and telephone sets.

All significant intercompany transactions have been eliminated, except for purchases of telecommunications equipment and supplies by the telephone subsidiaries from Microtel which are reflected in the consolidated financial statements at cost to the telephone subsidiaries, and are included in manufacturing sales in the consolidated statement of earnings. Intercompany sales for the three months ended December 31, 1979 totalled $12,317,000. To the extent that any income on these sales has not been offset by depreciation or other operating expenses, it remains in consolidated income and retained earnings. This practice is generally followed in the industry.

Income from Canadian operations includes $1,931,000 representing the results of operations of Microtel for the period from October 1, 1979 to December 31, 1979. Had the acquisition taken place on January 1, 1979, the income from Canadian operations would have included $4,845,000 for Microtel for the year ended December 31, 1979.

b) Depreciation

Depreciation of the telephone plant is provided on the straight-line method, for book purposes, based on engineering studies of the estimated lives and salvage value of the various classes of depreciable property.

Depreciation of the manufacturing property, for book purposes, is provided over the estimated useful lives of the assets using a straight-line basis.

c) Inventories

Inventories held by manufacturing subsidiaries are valued at the lower of cost or net realizable value.

d) Lease Transactions

Effective January 1, 1979, the Company and its subsidiaries revised their accounting policy relating to the method of accounting for lease transactions. Under the revised policy, leases are classified as capital or operating leases in accordance with the recommendation of the Canadian Institute of Chartered Accountants.

The revised policy has not been applied on a retroactive basis as the change has no material effect on the Company's earnings.

Assets recorded under capital leases are amortized on a straight-line basis over the life of the lease. Such amortization amounted to $2,968,000 for 1979. Payments on operating leases are expensed as incurred.

e) Loans for construction

The loans for construction have been used, principally, to finance the subsidiaries' construction programs, and it is expected that they will in time be refinanced by issues of long-term debt or equity capital.

f) Deferred credits

Certain subsidiaries are presently claiming for income tax purposes capital cost allowance in excess of depreciation charged to the accounts and other expenditures which are capitalized in their accounts. The resulting reduction in income taxes is deferred. The balance of taxes deferred by the subsidiaries included in Deferred Credits amounted to $367,494,000 and $314,480,000 as of December 31, 1979 and 1978, respectively.

g) Foreign exchange translation

Certain consolidated subsidiaries have debt payable in U.S. dollars. The principal means of accounting for such debt is to reflect in the financial statements the Canadian dollar equivalent at the rate of exchange prevailing at the end of the year. The unrealized loss on long-term debt of $10,791,000 is being amortized over the remaining term of the debt. This amortization amounted to $705,000 in 1979 and $658,000 in 1978.

Notes to Consolidated Financial Statements (continued)

2. COMMON SHARES, $10 PAR VALUE

Authorized — 1,700,000 shares

Issued and outstanding — 1,203,685 shares

3. ANTI-INFLATION COMPLIANCE AND ACCOUNTING REFINEMENTS

The CRTC, in its decision of December 13, 1978, directed that $25,325,000 of revenues generated by British Columbia Telephone Company in 1978 were in excess of revenues defined by the Anti-Inflation Act and regulations as allowable for that year and that those revenues were to be carried forward to 1979. Subsequently, in its decision of November 7, 1979, the CRTC directed that subsidiary to refund not less than $7,000,000 of those revenues to its 1979 customers. The subsidiary has complied with this directive.

The decisions rendered in 1979 by the CRTC and by the Régie des Services Publics du Québec introduced certain accounting refinements and directed their extension into the accounting practices of regulated telecommunications carriers so as to ensure uniformity of practices within the industry. The refinements required that certain overhead costs previously capitalized as telecommunications plant be expensed currently and that the application of equal life group depreciation practices be expanded to certain classes of plant acquired prior to 1975.

The introduction of these refinements together with a significant increase in the depreciation rates on switching equipment has resulted in additional operating expenses of $21,492,000, which were offset to a large extent by the 1978 revenues carried forward by British Columbia Telephone Company.

4. COMMITMENTS AND CONTINGENT LIABILITIES

a) Construction programs

The consolidated telephone subsidiaries' 1980 construction programs, as now planned, approximate $345,000,000 for which substantial purchase commitments have been made. These construction programs will be financed by cash available from operations and loans for construction pending permanent financing.

b) Lease obligations

Contractual obligations in respect of long-term leases of certain subsidiaries amounted to $25,642,000 for real property and equipment at December 31, 1979 and the related rentals were $5,380,000 in 1979 and $5,964,000 in 1978. The minimum amount applicable to the five years subsequent to December 31, 1979 is $23,585,000.

c) Pension plans

All companies maintain funded pension plans for the benefit of substantially all employees. The actuarially determined aggregate cost of maintaining the pension plans was $24,567,000 in 1979 and $21,179,000 in 1978, respectively, which includes $5,628,000 in 1979 and $4,139,000 in 1978 respectively, for the amortization of past service costs (over periods not exceeding 25 years from January 1, 1965) and of experience deficiencies. Such amounts were paid to trustees. The pension fund assets exceeded the actuarially computed value of the vested pension benefits of the plans at December 31, 1978, the latest valuation date. Due to improvements made to the pension plans during 1979, the present value of the estimated unfunded costs increased from approximately $14,538,000 as of December 31, 1978 to approximately $22,480,000 at December 31, 1979.

d) Contingent Liabilities

The Company is contingently liable in the amount of $8,280,000 for the payment of loans made to its unconsolidated Dominican subsidiary.

Microtel is contingently liable in the amount of $7,034,000 for the collection of notes receivable sold to an affiliated company.

Auditors' Report

To the Shareholders of
Anglo-Canadian Telephone Company:

We have examined the consolidated balance sheets and the summary of preferred and preference shares and long-term debt of Anglo-Canadian Telephone Company (a Quebec company) and subsidiaries as of December 31, 1979 and 1978, and the related consolidated statements of income, reinvested earnings and funds used for capital expenditures for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Anglo-Canadian Telephone Company and subsidiaries as of December 31, 1979 and 1978, and the results of their operations and funds used for capital expenditures for the years then ended, in accordance with generally accepted accounting principles applied on a consistent basis during the periods.

Arthur Andersen & Co.,
Chartered Accountants.

Montreal, February 1, 1980.

GTE

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